

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-07
L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15
USIA-06 SSM-03 IO-13 OMB-01 IGA-02 TRSE-00 AID-05
ACDA-12 COME-00 EB-08 LAB-04 SIL-01 /106 W
-----110515 090003Z /14

R 082138Z DEC 77
FM AMEMBASSY CAIRO
TO SECSTATE WASHDC 2650
INFO AMCONSUL ALEXANDRIA
AMEMBASSY AMMAN
AMEMBASSY DAMASCUS
AMEMBASSY JIDDA
AMEMBASSY KUWAIT
AMEMBASSY TEL AVIV

C O N F I D E N T I A L SECTION 01 OF 03 CAIRO 20735

E.O. 11652: GDS
TAGS: EGEN, EG, PFOR
SUBJ: ME PEACE AND REDUCTION OF GOE MILITARY EXPENDITURES--
- ECONOMIC PANACEA?

1. MOST EGYPTIANS AND MANY FOREIGN OBSERVERS BELIEVE THAT PRESIDENT SADAT'S VISIT TO JERUSALEM AND ATTENDANT POSSIBILITIES FOR PEACE WILL ULTIMATELY MEAN BETTER ECONOMIC TIMES FOR EGYPT. MORE SPECIFICALLY, EGYPTIANS HAVE LONG SPECULATED ABOUT REDUCTIONS IN MILITARY EXPENDITURES AND WHAT THIS COULD DO IF THOSE RESOURCES WERE DEVOTED INSTEAD TO DEVELOPMENT EFFORTS. IN LIGHT OF SADAT'S INITIATIVE, EMBASSY HAS ENDEAVORED TO ASSESS BRIEFLY A CHANGED SITUATION IN WHICH CURRENT HEAVY CONCENTRATION OF RESOURCES ON MILITARY WOULD NO LONGER BE NECESSARY. WE CONCLUDE THAT PEACE, WHILE OF COURSE DESIRABLE AND HELPFUL TO ECONOMY, WILL NOT SOON CAUSE RELEASE OF SIGNIFICANTLY LARGE RESOURCES FOR DEVELOPMENT
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PURPOSES.

2. FROM REVIEW OF DATA AVAILABLE IN CAIRO (SOME OF IT ADMITTEDLY CONTRADICTIONARY), IT SEEMS EVIDENT EGYPTIAN MILITARY EXPENDITURES HAVE CONTINUED TO RISE IN CURRENT POUNDS, ALBEIT marginally, SINCE OCTOBER 1973 WAR. THESE EXPENDITURES, HOWEVER, HAVE DECLINED SIGNIFICANTLY AS

PERCENTAGE OF OVERALL GOE EXPENSES AND IT IS NOT TOTALLY CERTAIN THAT ALL APPROPRIATED FUNDS IN FACT WERE SPENT. PUBLISHED GOE ADMINISTRATIVE BUDGET FIGURE IN 1974 FOR MINISTRY OF DEFENSE NONETHELESS WAS LE 289 MILLION (\$413 MILLION AT PARALLEL RATE, AS ARE ALL FOLLOWING CONVERSIONS); IN 1975, LE 309 MILLION (\$442 MILLION); IN 1976, LE 340 MILLION (\$486 MILLION); AND PRELIMINARY INDICATION FOR 1977 IS LE 350 MILLION (\$500 MILLION). (NOTE: LE 1.00 EQUALS \$1.43 AT PARALLEL RATE, COMPARED WITH \$2.56 AT OVERVALUED OFFICIAL RATE.) THESE FIGURES REPRESENT, RESPECTIVELY 32 PERCENT, 30 PERCENT, 29 PERCENT AND 27 PERCENT OF BUDGETED GOE ADMINISTRATIVE EXPENDITURES. IN FURTHER COMPARISON, IT IS ESTIMATED THAT 39 PERCENT OF 1973 BUDGET WENT TO DEFENSE.

3. GOE MILITARY FUNDS IN ADMINISTRATIVE BUDGET OVER PAST FOUR YEARS THUS HAVE AVERAGED \$460 MILLION EQUIVALENT ANNUALLY VALUED AT PARALLEL RATE, WHICH IS PROBABLY MOST APPROPRIATE INDICATION OF REAL RESOURCES INVOLVED.

4. CONCURRENT WITH ADMINISTRATIVE COSTS, ADDITIONAL MONIES IN LARGE AMOUNTS FROM OUTSIDE SOURCES FIND THEIR WAY INTO BUDGET FOR MILITARY (AS WELL AS DEVELOPMENTAL) PURPOSES THROUGH "EMERGENCY FUND" CHANNEL. COUNTING THESE ADDITIONAL FUNDS, WE ESTIMATE THAT TOTAL IDENTIFIABLE 1975 MILITARY EXPENDITURES APPROACHED LE 1
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BILLION (\$1.43 BILLION). IN 1976 FIGURE REACHED LE 1.1 BILLION (\$1.57 BILLION) AND PROBABLY WILL RISE SLIGHTLY AGAIN IN 1977. GRAND TOTAL AVERAGE ANNUALLY 1975-77 IN DOLLARS THEREFORE IS ABOUT \$1,570 MILLION AT PARALLEL RATE. ALTHOUGH IT IS KNOWN THAT APPRECIABLE PORTION OF EMERGENCY FUND EXPENDITURES ARE FOR NON-MILITARY PURPOSES (AN ESTIMATED LE 200 MILLION IN 1975 WAS FOR RECONSTRUCTION), IT HAS NOT BEEN POSSIBLE TO OBTAIN QUANTIFICATION OF THESE EXPENDITURES FOR MOST YEARS. OBVIOUSLY, TO EXTENT NOMINAL MILITARY PORTION OF BUDGET IS USED FOR DEVELOPMENTAL PURPOSES A REDUCTION IN MILITARY BUDGET DOES NOT FREE UP FUNDS FOR ADDITIONAL DEVELOPMENT.

5. DIVERSION OF AT LEAST SOME OF THESE TOTAL RESOURCES TO DEVELOPMENT ACTIVITIES OBVIOUSLY COULD BE BENEFICIAL. (SADAT TOLD AMBASSADOR IN LATE 1976 THAT HE, SADAT, ENVISAGED BEING ABLE TO REDUCE OVERALL MILITARY SPENDING A YEAR OR SO AFTER CONCLUSION OF A PEACE AGREEMENT BY ABOUT ONE-THIRD, OR SOME LE 400 MILLION.) FURTHER, BOOST TO FOREIGN INVESTMENT CLIMATE WHICH WILL BE GIVEN BY RENEWED PEACE EFFORTS POSSIBLY WOULD HELP AS MUCH AS BUDGETARY SAVINGS TO BUILD CONFIDENCE AND GET ECONOMY

MOVING.

6. SEVERAL FACTORS LIMIT ACTUAL AMOUNT OF AND BENEFIT DERIVED FROM PROJECTED SAVINGS, HOWEVER. ARMED FORCES, LIKE STATE-OWNED INDUSTRIAL SECTOR, HAVE BEEN SUBJECT OVER YEARS TO OVERSTAFFING SO AS TO ABSORB EXCESS LABOR. PRINCIPAL PORTION OF INCREASES IN ADMINISTRATIVE BUDGETS NOTED ABOVE WAS TAKEN UP IN MILITARY PAY RAISES IN EFFORT TO ASSURE SUPPORT OF PROFESSIONAL OFFICER CORPS FOR REGIME (WE ARE AWARE OF ONE 15 PERCENT PAY RISE) AND FOR INCREASING COSTS OF BASIC PROVISIONS AND LOGISTICAL SUPPORT. REDUCTION IN MILITARY FORCE WOULD AGGRAVATE UNEMPLOYMENT PROBLEM AND WOULD HAVE TO BE UNDERTAKEN CAREFULLY. THIS ADVERSE EFFECT IS WIDELY RECOGNIZED
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BY OBSERVERS OF EGYPTIAN ECONOMIC SCENE. ALTHOUGH LABOR SHORTAGES EXIST IN CONSTRUCTION AND THIS SECTOR COULD ABSORB SOME OF DEMOBILIZED FORCES,THIS WOULD PRESUMABLY

ONLY OCCUR WITH SPECIAL TRAINING EFFORT. PROBABLE OUT-COME OF PEACE AGREEMENT, THEREFORE, WOULD BE THAT MILITARY ESTABLISHMENT WOULD BE REDUCED ONLY AT MARGIN IN SHORT TO MEDIUM TERM AND CONSEQUENTLY SUBSTANTIAL BUDGETED SALARY/LOGISTIC ALLOCATIONS WOULD NOT BE AVAILABLE FOR DEVELOPMENT BUDGET. ARMED FORCES, IN TOTAL, NOW REPRESENT ABOUT 6 PERCENT OF LABOR FORCE.

7. IN ADDITION, OUTSIDE ARAB TRANSFERS TO "EMERGENCY FUND" MECHANISM ALMOST CERTAINLY WOULD DECREASE IF STATE OF WAR ELIMINATED. FUND WAS CREATED AFTER 1967 WAR TO SERVE AS REPOSITORY FOR MILITARY-RELATED ARAB GRANT ASSISTANCE AND IS STILL USED, BUT WE ARE UNSURE AS TO EXTENT CURRENTLY. IN PAST YEAR OR TWO ARAB DONORS MORE FREQUENTLY HAVE BY-PASSED FUND MECHANISM AND DEALT

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DIRECTLY WITH SUPPLIERS ON MILITARY EQUIPMENT PURCHASES. SUCH PROCEDURES MAKE IT DIFFICULT IF NOT IMPOSSIBLE FULLY TO ASSESS ACTUAL AMOUNTS OF ASSISTANCE RECEIVED. NEVERTHELESS, TOTAL AMOUNT OF RESOURCES AVAILABLE FROM ARAB DONORS PRESUMABLY WOULD DECLINE, RATHER THAN SHIFT TO DEVELOPMENT, IF NEEDS FOR MILITARY HARDWARE DECREASED AS CONSEQUENCE OF PEACE SETTLEMENT.

8. IN LONGER TERM, GOE MIGHT BE ABLE EFFECT MAJOR REDUCTION IN MILITARY FORCE AND THEN SHIFT DOMESTIC RESOURCES OTHERWISE EARMARKED FOR MILITARY SUPPORT, BUT IMMEDIATE EFFECT WOULD NOT BE INSTANT ECONOMIC REMEDY. WHILE SADAT INITIATIVE MAY WELL BE FIRST STEP TOWARD DAY WHEN GOE CAN CONSIDER MILITARY BUDGET CUTS, EGYPT FACES ECONOMIC PROBLEMS TOO NUMEROUS AND COMPLEX TO BE REVIEWED HERE. CORRECTION OF EXISTING SITUATION WILL REQUIRE TIME AND PLANNING, AS WELL AS MORE RESOURCES--THNA EVEN MILITARY BUDGET HAS TO OFFER.

9. PERHAPS MORE TO IMMEDIATE POINT THAN ACTUAL BUDGETARY GAINS, SADAT'S BOLD MOVE HAS, FOR TIME BEING, TAKEN EGYPTIANS' MINDS OFF THEIR ECONOMIC PLIGHT. PUBLIC PERCEPTION OF ECONOMIC PROBLEMS WHICH DEFY SHORT-TERM SOLUTION HAS TENDED TO VARY DIRECTLY WITH MOVEMENTS IN ME POLITICAL SPHERE. WITH PACE OF PEACE PROCESS QUICKENED BY JERUSALEM VISIT, INDIVIDUAL EGYPTIANS ARE ENCOURAGED AND PERHAPS ARE LESS INCLINED TO THINK ABOUT THEIR ECONOMIC WOES.

10. GIVEN THESE VARIOUS FACTORS, LARGE-SCALE SUPPORT BY FOREIGN DONORS --PRINCIPALLY THE ARABS AND U.S., BUT IMPORTANTLY INCLUDING IBRD AND IMF-- WILL CONTINUE TO BE

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OF PRIME IMPORTANCE IN EGYPT'S DEVELOPMENT POTENTIAL IN
BOTH SHORT AND MEDIUM TERM. THIS DEPENDENCE ON BOP AND

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PROJECT ASSISTANCE CAN BE EXPECTED TO CONTINUE DURING
1978-82 FIVE YEAR PLAN PERIOD, EVEN WITH AN OUTBREAK OF
PEACE, IF CURRENT PER CAPITA CONSUMPTION AND REASONABLE
OVERALL DEVELOPMENT-RELATED INVESTMENT LEVELS ARE TO BE
MAINTAINED. TOTAL VALUE OF RESOURCES DIRECTLY CONTROLLED
BY GOE AND DIRECTLY DEVOTED TO MILITARY ESTABLISHMENT IS
SMALLER THAN ONE MIGHT INITIALLY THINK, ESPECIALLY WHEN
MATCHED AGAINST THE MAGNITUDE OF EGYPT'S ECONOMIC
PROBLEMS, AND IN ANY EVENT LIKELY WILL NOT BECOME AVAIL-
ABLE TO SIGNIFICANT EXTENT OVER NEAR TERM. EILTS

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